



## Investing in Montana's Working Families: A Montana Earned Income Tax Credit (EITC) January 2015

In Montana, thousands of families struggle to make ends meet. One of the most promising policy opportunities to support working families and boost our economy is the enactment of a state Earned Income Tax Credit (EITC). The Great Recession and other economic trends made it harder for Montana's families to live above the poverty line. In fact, Montana has over 27,000 families that are working but are below or near the poverty line.<sup>1</sup> A sluggish economic recovery increased the struggles for low-income families. In addition, the Montana income tax system taxes families at an annual income far below the poverty line, pushing them further into poverty. The federal EITC program has been the most effective anti-poverty program in history, and a state-level credit could provide the same benefits to Montana families.<sup>2</sup>

*"The [Earned Income Tax Credit] is the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress."*

- President Ronald Reagan

### Why Does Montana Need a State Earned Income Tax Credit?

#### Montana's Income Tax System Pushes Working Families Further into Poverty

Montana is one of only five states in the country to impose income taxes on working families experiencing poverty.<sup>3</sup> **Currently, we begin taxing a single person at \$4,360, a single parent with two children at \$9,120, and a couple with two children at \$13,480.**<sup>4</sup> Enacting a state EITC would help mitigate the impact these low taxation thresholds have on Montana's families and prevent them from being driven into poverty.

#### Economic Trends Add to Family Struggles

Recent economic trends have made it challenging for many of Montana's working families to make ends meet. In 2014, a single parent working full-time for minimum wage would earn approximately \$16,432. That's \$7,418 below the Federal Poverty Line for a family of four.<sup>5</sup> **Over 27,000 Montana families were working, but earning less than 200% of the poverty line.**<sup>6</sup> Unfortunately, Montana's income tax makes it even harder for many of these families to purchase basic necessities.

#### Key Findings

- Besides Social Security, **the federal Earned Income Tax Credit has been the most effective anti-poverty program in history.**
- In 2013, the federal EITC **lifted more than 6.2 million people, including 3.2 million children, out of poverty.**
- In 2012, the federal EITC **generated \$151 million into Montana's economy.** A state EITC would contribute an additional \$17 million into Montana communities.
- A federal and state EITC would effectively **raise the wage of a single mother with two children by \$2.93 per hour.**
- Over **80,000 Montanans received the federal EITC in 2013.** These same families would benefit from a state EITC.



## What is the Federal EITC?

The federal EITC is a tax credit created by Congress in 1975. Since the credit is refundable, the federal EITC acts as a wage supplement for low-income working families across the nation. Only working individuals and families that pay taxes are eligible for the EITC.<sup>7</sup> In 2015, a family with three children could receive an EITC benefit of \$6,242.<sup>8</sup>

### The Federal EITC is Effective.

- **In 2013, the federal EITC lifted more than 6.2 million people, including 3.2 million children, out of poverty.<sup>9</sup> In the same year, over 80,000 Montanans received the federal EITC.**
- Expansions of the federal EITC have been found to encourage work among single parents. Since EITC benefits increase with earnings, there is an incentive for low-income individuals to work more and for the unemployed to leave welfare for work.<sup>10</sup>
- The federal EITC is largely used on a temporary basis. Most recipients receive the credit for a year or two to cover temporary costs like loss of income.<sup>11</sup>
- Recognizing the effectiveness of the federal EITC, twenty-five states have enacted state EITCs to further supplement the income of working families.<sup>12</sup>
- Credits targeted at low-income households are an efficient way to increase demand for goods and services because low-income families are more likely to spend added income on immediate needs like groceries and school supplies, resulting in an immediate economic boost in our local communities.<sup>13</sup> In 2012, the federal EITC stimulated about \$151 million into Montana's economy.<sup>14</sup>
- Military families also benefit from the federal EITC. In 2013, roughly 8,000 veteran and Armed-Forces families in Montana experienced reduced poverty because of the federal EITC.<sup>15</sup>

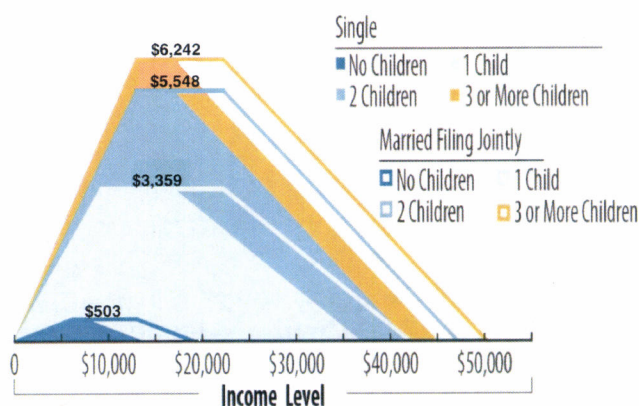
*"Lower-income households are . . . more likely to be among those with the highest propensity to spend. Therefore, policies aimed at lower-income households tend to have greater stimulative effects."*

Congressional Budget Office ("Options for Responding to Short-Term Economic Weakness," January, 2008).

## How Does the Federal Earned Income Tax Credit Work?

Only low-income families and individuals with earnings from work are eligible for the federal EITC. The size of the credit depends on family size and income and is divided into three benefit ranges: (1) the phase-in range where EITC benefits increase with earnings; (2) a plateau where the maximum EITC amount remains constant; and (3) the phase-out range where benefits decline as earnings increase (Figure 1).<sup>16</sup> Most families claim their EITC in a lump sum when they file their federal income tax return. Alternatively, a small number of families choose an advance payment option, receiving the credit throughout the year as a supplement to their paycheck.

Figure 1– Value of the Federal Earned Income Tax Credit, 2015



Source: Internal Revenue Service. 2015 EITC Income Limits

## How Would a State EITC Work?

Most states model their EITCs after the federal credit.<sup>17</sup> The best option for a state EITC is to offer workers a refundable tax credit that is equal to a fixed percentage of the federal credit. For example, Montana could offer an EITC equal to 10% of the federal credit. Linking state and federal eligibility makes the process easier. Montana can take advantage of federal compliance and coordinated efforts to publicize the credit to eligible families.

Like the federal EITC, a state EITC could only be claimed by people who are working and paying taxes. The process to claim the credit is simple and would have powerful effects for Montana's working families. The EITC is first used to reduce a family's tax liability, the amount a family owes in taxes at the end of the year. If the credit exceeds a family's tax liability, the remaining balance is returned to the family in the form of a refund. **In Montana, a state EITC set at 10% of the federal credit would result in a maximum benefit of \$624 for low-income working families, with a total cost to the state of approximately \$17 million in 2016.**<sup>18</sup>

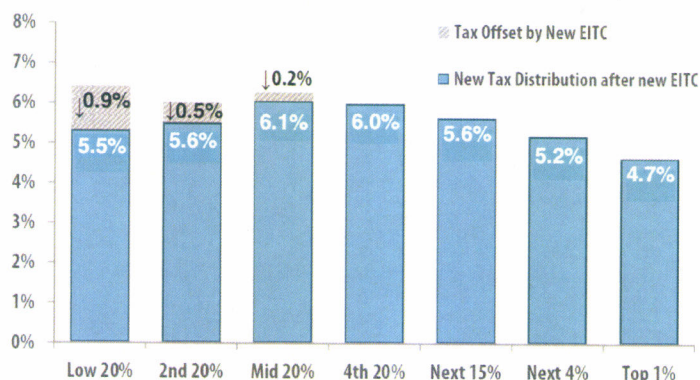
## Who Would Benefit from a Montana EITC?

### Individuals and Families

Over 80,000 Montanans received the federal EITC in 2013.<sup>19</sup> If Montana establishes a state EITC, these working families would receive additional support, supplementing their wages and helping them meet their families' needs. Additionally, Montana's low-income families would face a reduced tax burden because a state EITC tax credit would offset the amount of total taxes owed (Figure 2).<sup>20</sup>

In 2015, a three-person household supported by a parent working full-time at minimum wage will still fall below the poverty level. However, a combination of the state and federal EITC could raise that family out of poverty (Table 1). The increase in income from a federal and state EITC is equivalent to a wage increase of \$2.93 per hour for a single mother with two children.

Figure 2 - a state EITC reduces the tax burden on Montana's low-income families



Note: Reduced tax burden with state EITC set at 16% of federal EITC

Source: Institute on Taxation and Economic Policy. 2014

### Children

Children are one of the most important beneficiaries of the EITC. The federal EITC is the nation's most successful anti-poverty program for children. Without it, the number of children living in poverty would be 25% higher than it is today.<sup>21</sup> The benefits are also long-lasting. Children who move out of poverty in early childhood tend to perform better in school, receive more schooling later in life, work more hours, and have higher future earnings.<sup>22</sup>



**Table 1 - State Earned Income Tax Credits Help Families Supported by Low-Wage Earners**

	Gross earnings at minimum wage (\$8.05)	% of 2015 Federal Poverty Guideline	Federal EITC Benefit	State EITC Benefit at 10% of Federal EITC	Sum of Earnings, Federal and State EITCs	Equivalent per hour raise
<b>Single Parent</b>						
0 Children	\$16,744	142%	*Does not Qualify	n/a	\$16,744	\$0
1 Child	\$16,744	105%	\$3,359	\$336	\$20,439	\$1.78
2 Children	\$16,744	83%	\$5,548	\$555	\$22,847	\$2.93
3 Children	\$16,744	69%	\$6,242	\$624	\$23,610	\$3.30
<b>Married</b>						
0 Children	\$33,488	213%	*Does not Qualify	n/a	\$33,488	\$0
1 Child	\$33,488	169%	\$3,359	\$336	\$37,183	\$1.78
2 Children	\$33,488	140%	\$5,548	\$555	\$39,591	\$2.93
3 Children	\$33,488	120%	\$6,242	\$624	\$40,354	\$3.30

\*Notes:

a- Individual's income is above the \$14,820 qualifying threshold. Below this limit and with no children the individual could benefit from a maximum Federal EITC of \$503.

b- The couples' dual income is above the \$20,330 qualifying threshold. Below this limit and with no children they could benefit from a maximum Federal EITC of \$503.

## Employers

The EITC serves as a wage supplement, helping businesses find labor at affordable rates while workers earn enough to save, pay for housing, and plan for the future. In short, the EITC incentivizes working in order to boost overall wages. Wage increases resulting from end-of-year tax credits will help sustain employment for families by helping low-wage employees afford essentials such as transportation and childcare.

## Rural Areas and Small Towns

While nationally, most beneficiaries live in large cities, rural areas receive a disproportionate amount of the benefits relative to population size. Twenty-one percent of rural Montanans claimed a federal EITC in 2013, compared to 17% of the entire population.<sup>23</sup> These additional funds bring in millions of dollars and support rural communities, families, small businesses, and economies.

## The Economy

In 2012, the federal EITC injected \$151 million into Montana's economy. A state EITC at 10% of the federal EITC would contribute an additional \$17 million each year to Montana's communities.<sup>24</sup> EITC recipients will spend their additional income at the grocery store, the gas station, and other businesses. By placing the money in the hands of the people most likely to spend it, a state EITC would increase demand for goods and services and boost local economies.



## Conclusion

A state EITC is an incredible opportunity for Montana to improve the lives of low-wage workers and their families across the state. However, the EITC benefits far more than the state's low-income workers. The credit boosts the economy, protects children, and helps keep costs down for employers.

By encouraging people to work, and supplementing their wages, the federal EITC program has been a successful anti-poverty program. Montana should take this opportunity to help make work pay for low-income and working families. Our families, communities, and the economy will be stronger as a result.

<sup>1</sup> United States Census Bureau. 2013 American Community Survey 1- Year Estimates. Montana Economic Characteristics. [factfinder.census.gov](http://factfinder.census.gov)

<sup>2</sup> Arloc Sherman, Danilo Trisi, and Sharon Parrott. *Various Supports for Low-Income Families Reduce Poverty and Have Long-Term Positive Effects on Families and Children*. Center on Budget and Policy Priorities. July, 2013. <http://www.cbpp.org/cms/?fa=view&id=3997>

<sup>3</sup> Phil Oliff, Chris Mai, and Nicholas Johnson. *The Impact of State Income Taxes on Low-Income Families in 2011*. Center On Budget and Policy Priorities. April, 2012. <http://www.cbpp.org/cms/?fa=view&id=3740>

<sup>4</sup> On file with author. Montana Department of Revenue. February, 2015.

<sup>5</sup> In 2014, Montana's minimum wage was \$7.90/hr and the federal poverty guidelines for a family of 4 was set at \$23,850. <http://aspe.hhs.gov/poverty/14poverty.cfm>

<sup>6</sup> Near poor defined as earning less than 200% of the federal poverty line. A total of 145,737 employed individuals had children under the age of 18 in Montana in 2013. 19% of families (27,690) were below the poverty line. United States Census Bureau. 2013 American Community Survey 1- Year Estimates. Montana Economic Characteristics. [factfinder.census.gov](http://factfinder.census.gov)

<sup>7</sup> For more information on 2015 qualifying criteria, income limits, and maximum credit amounts see: Internal Revenue Service. 2015 EITC Income limits. <http://www.irs.gov/Individuals/Preview--EITC-Income-Limits>

<sup>8</sup> Internal Revenue Service. 2015 EITC Income limits. <http://www.irs.gov/Individuals/Preview--EITC-Income-Limits>

<sup>9</sup> Center on Budget and Policy Priorities. *Policy Basics: The Earned Income Tax Credits*. January, 2015. <http://www.cbpp.org/files/policybasics-eitc.pdf>

<sup>10</sup> Nada Eissa and J.B. Liebman. *Labor Supply Response to the Earned Income Tax Credit*. Quarterly Journal of Economics, Vol. 111 No. 2. May, 1996. <http://www.hks.harvard.edu/jeffreyliebman/eissaliebmanqje.pdf>

<sup>11</sup> Chuck Marr, Chye-Ching Huang, and Arloc Sherman. *Earned Income Tax Credit Promotes Work, Encourages Children's Success at School, Research Finds*. Center on Budget and Policy Center. April, 2014. <http://www.cbpp.org/cms/?fa=view&id=3793>

<sup>12</sup> Center on Budget and Policy Priorities. *Policy Basics: The Earned Income Tax Credits*. January, 2015 <http://www.cbpp.org/files/policybasics-eitc.pdf>

<sup>13</sup> Seth Hartig, Curtis Skinner, Mercedes Ekono. *Taxing the Poor: State Income Tax Policies Make a Big Difference to Working Families*. National Center for Children in Poverty. November, 2014. [http://www.nccp.org/publications/pdf/text\\_1093.pdf](http://www.nccp.org/publications/pdf/text_1093.pdf)

<sup>14</sup> Center on Budget and Policy Priorities. *Montana Fact Sheet: Tax Credits Promote Work and Fight Poverty*. 2012 <http://apps.cbpp.org/3-5-14tax/?state=MT>

<sup>15</sup> Arloc Sherman and Bryann DaSilva. *Working-Family Tax Credits Help Over 1 Million Veteran and Armed-Forces Families*. Center on Budget and Policy Priorities. December, 2014. <http://www.cbpp.org/cms/index.cfm?fa=view&id=3986>

<sup>16</sup> Internal Revenue Service. 2015 EITC Income limits. <http://www.irs.gov/Individuals/Preview--EITC-Income-Limits>

<sup>17</sup> National Conference of State Legislators. *Tax Credit For Working Families: Earned Income Tax Credit*. July, 2014. <http://www.ncsl.org/research/labor-and-employment/earned-income-tax-credits-for-working-families.aspx>

<sup>18</sup> Costs forecaster for FY 2015. Erica Williams and Michael Leachman. *How Much Would a State Earned Income Tax Credit Cost in FY 2015?* Center on Budget and Policy Priorities. December, 2013. <http://www.cbpp.org/cms/index.cfm?fa=view&id=2992>

<sup>19</sup> Internal Revenue Service. Earned Income Tax Credit. Statistics for Tax Returns with EITC. 2013. <http://www.eitc.irs.gov/EITC-Central/eitcstats>

<sup>20</sup> Carl Davis et al. *Improving Tax Fairness with a State Earned Income Tax Credit*. Institution on Taxation and Economic Policy. May, 2014. <http://www.itep.org/pdf/eitc2014.pdf>

<sup>21</sup> Center on Budget and Policy Priorities. *Policy Basics: The Earned Income Tax Credits*. January, 2015. <http://www.cbpp.org/files/policybasics-eitc.pdf>

<sup>22</sup> Center on Budget and Policy Priorities. *Policy Basics: The Earned Income Tax Credits*. January, 2015. <http://www.cbpp.org/files/policybasics-eitc.pdf>

<sup>23</sup> Jon, Bailey. *Earned Income Tax Credit and Rural Households*. Center for Rural Affairs. October, 2014. <http://files.cfra.org/pdf/EITC-final.pdf>

<sup>24</sup> Erica Williams and Michael Leachman. *How Much Would a State Earned Income Tax Credit Cost in FY 2015?* Center on Budget and Policy Priorities. December, 2013. <http://www.cbpp.org/cms/index.cfm?fa=view&id=2992>